EXPOSURE DRAFT

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Measurement Concepts of Accounting and Financial Reporting in the Federal Government.

United States General Accounting Office

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UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548

ACCOUNTING AND FINANCIAL
MANAGEMENT DIVISION

Under the Accounting and Auditing Act of 1950, the General Accounting Office (GAO) is responsible for establishing accounting standards for Federal agencies. To carry out this responsibility, GAO first established standards in 1952 and has revised them periodically. Since recent years have seen many advances in accounting theory and practice, we have decided to reexamine these Federal Government standards first in concept and then in practice to see if changes are needed or desirable.

Our first goal is to develop a conceptual framework within which consistent Federal accounting requirements can be maintained. Once this framework is completed, we will reevaluate the accounting, reporting, and operational requirements to determine the needed changes. We expect long-range benefits of this effort to be more useful information in financial reports.

Our effort is divided into four stages: objectives, fundamentals, standards, and operational criteria. The objectives and the fundamentals together make up the conceptual framework. Objectives are the goals toward which accounting and financial reporting is directed. Fundamentals are concepts which serve as guidelines for determining and establishing standards. Standards are the rules for reporting financial activities and events, and operational criteria are the procedural or detailed system aspects that facilitate application of the standards.

Initial work on the first stage--the objectives--was recently completed and an exposure draft was issued for comments. The first item in the fundamental concept level--the elements of financial reporting--was recently completed and an exposure draft issued for comment.

This document addresses the second item in the fundamental concept level--the bases for measuring the attributes of elements of financial reporting. Other items to be addressed in the fundamental level include identification of the reporting entity and recognition concepts.

Similar efforts are underway by the Financial Accounting Standards Board (FASB), the standard-setting body for the private sector and the National Council of Governmental Accounting (NCGA), the recognized standard-setting body for State and local governments. The FASB is working to establish a conceptual framework for accounting and the NCGA is doing research for State and local government accounting. Also, a State government accounting project sponsored by the Council of State Governments is refining the reporting requirements for State governments. In September 1979, the FASB issued Statement of Financial Accounting Standards No. 33, "Financial Reporting and Changing Prices." This statement established standards for reporting certain effects of price changes on large business enterprises.

Although the FASB has done much to establish standards for measuring elements in the private sector, we do not believe such standards unquestionably apply to the Federal sector. We believe that the Federal Government is sufficiently different from profit and nonprofit entities in the private sector to warrant separate studies on accounting and financial reporting, and to warrant developing a separate conceptual framework which includes measurement. Nevertheless, in developing fundamental measurement concepts we drew upon the FASB's work and the work of the NCGA and the State Government Accounting Project to the extent it could be applied to the Federal sector.

This document is issued as an exposure draft to Federal departments and agencies, to members in the accounting profession and the academic community, and to interested persons in the financial community. We encourage your review of this document and solicit your comments on how it can be improved and on whether the measurement concepts it identifies and defines seem to be appropriate for the Federal Government. We acknowledge that there are costs of providing and using financial information, as well as benefits. The particular financial disclosure proposed in this document may very well require changes in the methods used to compile accounting data. To justify requiring a particular financial disclosure the benefits to be derived should exceed the costs associated with it. Although making this evaluation is difficult, we encourage you to comment on any changes you perceive as necessary to an entity's (or your entity's) accounting system stemming from the disclosure suggested in this document. Please send these comments by January 30, 1981 to:

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Sincerely yours,

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PROPOSED STATEMENT ON

ACCOUNTING AND FINANCIAL REPORTING

OF THE FEDERAL GOVERNMENT

ISSUED FOR COMMENT

MEASUREMENT CONCEPTS OF ACCOUNTING AND FINANCIAL REPORTING

CONTENTS

MEASUREMENT CONCEPTS OF ACCOUNTING AND FINANCIAL REPORTING IN THE FEDERAL GOVERNMENT

INTRODUCTION

1. The overall accounting and financial reporting structure in the Federal Government has two major components: the conceptual framework and the practice requirements. The conceptual framework consists of two levels: the objectives, which are established in the February 29, 1980, Exposure Draft entitled "Objectives of Accounting and Financial Reporting in the Federal Government," and the fundamental concepts, which includes measurement and valuation concepts that will be defined by this statement. The practice requirements also consist of two levels: the standards and the operational criteria. Each level of the structure builds upon the base provided by the preceding level.

2. This statement focuses on the basis of measuring the elements of financial reports and is only one of the many concepts to be included in the fundamental level of the conceptual framework. The first concept of the fundamental level covers the elements of financial reports. These are established in the August 12, 1980, Exposure Draft entitled "Elements of Accounting and Financial Reporting in the Federal Government." Concepts to be covered by other statements include identification of the reporting entity, recognition concepts, and reporting concepts. Although this statement makes numerous references to

measurement concepts to be reported, it discusses reporting in only a general sense. The reporting concepts will give guidance on disclosure, general format, and basic statement structure. Attached figures 1 and 2 describe plans for the fundamental concept level.

3. This statement does not specify accounting standards, procedural requirements, or reporting standards as does GAO's "Policy and Procedures Manual for Guidance of Federal Agencies." Rather, it is intended to provide the basis for interpreting, establishing, and maintaining standards. Although the measurement concepts in this statement may not be consistent with those in the manual, GAO will re-evaluate the manual requirements and make appropriate additions, deletions, or other modifications when the conceptual framework is adopted.

MEASUREMENT SUMMARIZED

4. Financial reports focus on elements related to the reporting entity. Measurement concepts provide the means for quantifying elements in terms of dollars. The quantifying of elements helps users of financial reports to understand, explain, predict, plan, and control the activities of an entity as well as the elements which make up its financial reports.

5. Traditionally, the elements of financial reports are valued based on dollars exchanged at the time events are realized and recognized in the accounts. This measurement concept is commonly referred to as historical cost accounting. A strong reason supporting the use of historical costs is that they are verifiable since they usually represent cash outlays.

However, one of the main disadvantages of historical cost valuation is that the value of assets and expenses associated with the use of assets changes over time. These price changes occur for several reasons including inflation, technological improvements, and supply factors. Users need financial information measured on bases in addition to historical costs that disclose how past economic decisions affect current and future outcomes. In this respect, current exchange prices are more relevant than past exchange prices.

6. Measurement in the Federal Government should be directed toward providing information that is relevant for specific uses. This statement identifies three principal measurement bases that help achieve the objectives of accounting and financial reporting. These bases are historical cost, constant dollar, and current value accounting.

7. For purposes of this statement, these bases are defined as follows:

Historical cost accounting	A method of measuring elements in dollars exchanged at the time of transaction and recognized without restatement into units each of which has the same general purchasing power.
Constant dollar accounting	A method of measuring elements in dollars each of which has the same general purchasing power.
Current value accounting	A method of measuring elements at current exchange prices.

8. Historical cost information is traditional and more reliable than other valuation methods since it is most objective and verifiable. It therefore can be used with greater confidence. However, spiraling inflation over the past 2 decades has rendered historical cost information less relevant for assessing all aspects of performance. As a result, this statement recommends supplementing traditional historical cost reporting by reporting constant dollar and current-value measurements.

9. This statement identifies and discusses historical costs, constant dollar, and current value measurement bases of financial reports. It defines each basis and describes the characteristics and uses of each. In addition, it stresses that each basis is valid depending upon the circumstances encountered and that flexibility should be maintained. The particular circumstances will determine which measures are most meaningful to a Government entity or to the users of an entity's financial reports. The choice to use one valuation basis rather than another should be the result of a combination of considerations in addition to assessing user needs. These include the desired level of precision and reliability, the desired degree of relevancy, and the cost of employing a particular basis.

MEASUREMENT DEFINED

10. Measurement concepts are the bases for assigning numeric values to elements of financial reports. Financial reports focus on the economic resources of the reporting entity. Economic resources are generally considered items of value to society, individuals, and entities and as such are expected

to yield benefits. Because of their value, all known economic resources are claimed by society, individuals, or entities. Elements are the classification of economic resources, corresponding claims to resources, and the related changes in them. As such, elements are the component parts of financial reports. The exposure draft on elements identified, defined, and characterized seven major elements: assets, liabilities, equity of the U.S. Government, income, costs, gains and losses, and results of operation. Measurement concepts provide the fundamental means, methods, or processes by which specified dollar amounts can be attached to elements or component parts of elements.

11. Measurement concepts are derived from the basic proposition that there exists a common and standard unit to measure value. Money is the accepted scale for measuring value throughout the world, and in the United States the dollar constitutes that unit of measure. There are, however, other units to measure quantities which do not include dollars. Examples are number of loans authorized or number of loan guarantees granted, number of local governments receiving revenue sharing funds, and number of children receiving school lunch program meals. Although these quantities are useful and may appear in financial reports, the need to provide guidance in deriving them is not critical. Therefore, this statement is devoted to those measurement concepts dealing exclusively with dollar amounts.

12. Measurement concepts provide the basis for assigning dollar amounts to elements of financial reports. In applying measurement concepts two criteria must be met:

1. An element or component part of an element will be recognized in financial reports.

2. The element or component of an element is quantifiable in terms of dollars.

13. To apply measurement concepts an element, or a component part of one, must be recognized in financial reports either as a single item itself or as part of another more general element. Although this statement does not deal with recognition concepts nor the criteria necessary to recognize an element, it is essential that an element be a reportable item to apply measurement concepts. Conversely, if an element is not a reportable item measurement concepts do not apply. An example of this is human resources measured in terms of the knowledge, ability, and imagination possessed by employees of a government agency. Human resources can be considered to meet the definition of an asset; however, if traditional accounting concepts are applied, human resources do not qualify as a reportable element. (Subsequent statements in the fundamental level will cover recognition concepts.)

14. The second criterion requires the element to be quantifiable in terms of dollars. To be quantifiable, an element must possess attributes that can be subjected to reasonably reliable measurements or estimates. To be reliable, measurement estimates must possess an acceptable degree of objectivity and verifiability. Objectivity refers to being unbiased while

verifiability refers to corroboration. Objective and verifiable measurement estimates should result from a consensus of qualified experts. Measurement estimates having a low degree of objectivity and verifiability should not be assigned to elements appearing in the primary statements of financial reports. For example, certain elements such as intangible assets (mineral rights, licenses, and trademarks), are difficult to measure mainly because of the high degree of uncertainty about future benefits in terms of dollars. If for such elements an acceptable degree of objectivity and verifiability of measurement estimates cannot be achieved, measurement cannot occur. Such elements may be best presented narratively in financial reports without related dollar amounts.

LIMITATIONS ON MEASUREMENT CONCEPTS

15. The purpose of this statement is to identify and define methods of measuring elements. The measurement concepts in this statement will provide a broad basis for establishing, interpreting, and applying accounting and reporting standards. However, inherent limitations should be taken into account to help users of this statement understand the environment relevant to the measurement bases discussed.

16. First, as previously mentioned, measurement concepts are based on the existence of a common denominator--in the form of money--to use as a unit of measure. Adoption of a common denominator provides no assurance that attributes of elements being measured are compatible with one another.

This is because financial statements contain approximated and estimated valuations. Examples of estimates used in accounting are depreciation expense or, in the case of a resource acquired in exchange for another, the fair market value of the resource acquired.

17. Another limitation in establishing measurement concepts and subsequent standards is the fact that there has been little experimentation within the Federal Government with alternative methods of valuing elements. The information now presented in financial reports is based mainly on the historical costs of the elements being measured. As a result, little is known in practice about the usefulness and costliness of valuing elements by methods other than historical cost, such as current value methods.

18. If financial reports disclose current value information, that information will not be as objective as historical cost information. Current values are assigned through subjective determinations of what would have to be spent currently to replace items.

19. Another inherent limitation of measurement concepts lies in the dynamic nature of accounting. Accounting thought and practice are changing continuously as a result of reassessments of user needs and the changing state of the art. Determining the type and amount of financial information and the methods of measuring this data will, therefore, be based on user needs and accounting advances. However, the specific needs of users taken collectively may be incompatible and require such a

vast amount of financial information that the cost of providing it would far exceed the collective benefits. Decisions about what information should be accounted for and how it should be measured are therefore based on aggregate user needs. As a result, tradeoffs between diverse needs, relevancy and reliability, and costliness will be necessary to achieve the practical objectives of accounting and financial reporting.

20. In some instances financial reports contain economic resource information that is not readily quantifiable in terms of dollars. This nonquantified data on elements can include descriptions of various qualitative characteristics of resources or claims to resources. Estimates of unmined minerals and proved reserves of oil and gas are examples of unquantifiable information. Such estimates are merely educated guesses upon which reliable values cannot always be determined. Nonetheless this type of resource information is helpful in attempting to forecast future operations.

21. The measurement concepts are interrelated with other concepts which serve as guidelines for determining and establishing standards. For example, measurement concepts are based on elements--the events, resources, and obligations to be accounted for. As a consequence, the limitations discussed in the statements on objectives and on elements of accounting and financial reporting carry over to the measurement concepts discussed in this statement.

MEASUREMENT IN RELATION TO OBJECTIVES

22. The February 29, 1980, exposure draft "Objectives of Accounting and Financial Reporting in the Federal Government" identified the objectives as providing information useful in assessing fiscal compliance, program activity, financial viability, and resource allocation. Information that is useful in assessing the objectives must be presented in terms describing elements related to the entity. In turn, the elements must be measured in ways that convey economic realities. Too often there is an assumption on the part of users of financial statements that the statements are based on historical costs. This is not always true. In fact, there are other valuation methods used--such as inventories being reported at net realizable value if lower than cost--and a wide array of estimates based on relatively subjective considerations such as depreciation expense and losses on loans and other receivables. It is generally accepted, therefore, that various circumstances exist when historical costs are not the best indicators of value. An attempt is made in this document to define a more useful measurement concept for valuing the elements of financial statements. This statement focuses on three ways of measuring economic resources to accomplish these objectives. They are: historical cost, constant dollar, and current value accounting. The following paragraphs discuss the relevance of each of the above measurement bases in relation to the objectives of Federal Government financial reports.

Historical Cost Accounting

23. Financial data in reports should be valued mainly on historical costs to maintain dollar compatibility with budget authority. Historical costs are measured in terms of money agreed upon in transactions to which the entity was a party when the transactions were initially entered into. They are thus more comparable to the dollar authorizations and limitations initially granted. As a result, financial reports based mainly on historical costs will be neutral to the extent possible. This increases the objectivity, comparability, and usefulness of financial information.

24. Financial reports based on historical costs indicate the entity's compliance with laws and regulations. This enables users of the reports to assess how an entity discharged its accountability. Financial reports can show operations by authorization categories and the related authorization amounts, commitments, and obligations incurred in financial statements or they can use formats not considered traditional in displaying budget data. For example, financial reports could include a supplementary schedule disclosing the status of appropriations for major activities within programs.

25. Financial reports based on historical costs also provide some of the information useful in assessing financial viability. Financial viability refers to the ability of an entity to provide the same level of resources that it either has provided in the past or has indicated it expects to provide in the future. For users to obtain these indications, financial

reports should describe economic resources which reflect an entity's current position, past performance, and future expectations. Financial reports based on historical costs also provide users with information for assessing to a reasonable degree whether program objectives have been or are being achieved by comparing actual resources and obligations per program to those initially planned.

26. Historical cost information is an integral component of budget preparation and execution because information about past transactions provides valuable input to planning the allocation of available resources among alternatives for accomplishing program objectives. In this respect, information on fiscal compliance, financial viability, and program activity will have a direct impact on budget execution.

Constant Dollar Accounting

27. Until now, the discussion focused on the relevance of reporting elements of financial reports at historical costs. Although historical cost accounting is fairly reliable and conceptually sound, one major limitation is that it compares income in terms of dollars received currently with costs in terms of dollars spent in the past. In periods of rising prices, which have been a persistent recurrence in our economy, this creates a problem because replacement of inventory and productive assets is continuously becoming more costly. As a result of this inflation, elements disclosed in financial reports on a historical cost basis may not show the true value at the date of the report.

28. Inflation can be defined as a prolonged rise in most prices. It creates an unstable monetary unit, and using only historical costs in reporting can lead to misleading information because dollars of different purchasing power are combined and disclosed in reports. Financial information prepared on the basis of historical prices simply has not lived up to describing the effects inflation has had on the Federal Government; consequently, conventional reporting for every situation is not adequate for assessing future resource needs. In years of moderate inflation, the deficiencies in historical cost information were accepted because no one could justify the effort required to develop a better alternative. However, the impact of current inflation provides the impetus for developing that better alternative. Additional information measuring the effects of general price changes is now sought to give users further information on the efficiency and effectiveness of management performance.

29. In the Federal Government, financial information depicting viability and program activity should disclose the inflationary effect of price changes on all resources of the entity. This can be done by measuring the relative price change for all goods and services through a method referred to as "constant dollars." Financial information that is measured in historical costs and adjusted to show the effects of inflation on the elements in financial

reports can help users assess the amount of resources an entity will need to provide the same quantity of goods and services in the future. Also, by disclosing the impact of inflation on past program activity during budget preparation, more realistic allocations of resources can be made to meet future expectations. This is exemplified by the Office of Management and Budget's experimentation with constant dollar accounting in the preparation and execution of the Federal budget. The general price level is a measure of relative price change for all goods and services. This means the prices of all individual goods and services are weighted to develop a ratio that represents the universe. Price changes can be combined into one index to relate data at different points in time in "constant dollars"--dollars having ostensibly identical purchasing power. The benefit of using the constant dollar approach is that the measuring unit (historical costs) serves as a common denominator for adding, subtracting, and comparing the elements related to an entity. Also, by adjusting historical costs to reflect general inflation, users' understanding of the effects of changing prices on an entity will be enhanced.

30. Financial information measured in constant dollars should present the general purchasing power of the dollar at the date of the report. Adjusting certain elements from their historical cost to constant dollars, however, creates certain gains and/or losses because of the change in the

general purchasing power. To clarify this, elements must first be classified into monetary and nonmonetary. Monetary elements designate cash and other resources and obligations usually expected to be settled by payments in specified cash amounts. All other resources are specified as nonmonetary.

31. Monetary elements are finite in dollar amounts in the sense that a fixed number of dollars will be received or paid even though purchasing power can differ. Therefore, the economic significance of monetary assets and liabilities depends heavily on the general purchasing power of money. Holders of monetary assets, such as cash and receivables, lose purchasing power during periods of inflation because monetary assets buy fewer goods and services when the general level of prices rises. On the other hand, those who have monetary liabilities gain because liabilities will be paid by dollars having less purchasing power than they had when the liabilities were initially incurred. As a result, an entity will experience a "purchasing power" gain or loss during periods of price changes. The purchasing power gain or loss on monetary items is equal to the net gain or loss after restating in constant dollars the opening and closing balances of monetary assets and liabilities. The reporting of purchasing power gains and losses on monetary items should provide for an improved understanding of some of the implications of the monetary components of working capital and the amount of public debt held by the Federal

Government in periods of inflation. For this reason monetary assets reported at historical costs should also be reported to reflect the effects of general inflation in terms of constant dollars. The net gain or loss does not represent receipt of or payment of cash and should not be considered as providing or using funds in the current period.

32. In the case of nonmonetary elements--for example, buildings and equipment--differences resulting from general price level changes can be eliminated by the use of constant dollar accounting. No gain or loss accompanies the valuation change because the change does not represent a market price change arising from supply and demand. It represents a restatement of the investment in the elements.

Current Value Accounting

33. Measuring elements of financial reports at current values allows several important uses. It permits a matching of current values with current revenues to provide a better measure of the results of operations. This information provides a better indication of how efficiently and effectively management is operating and is helpful in assessing stewardship and performance. It also eliminates the need for any assumption regarding the actual or arbitrary flow of costs. Thus, the application of various inventory costing methods is unnecessary and the inconsistencies of the lower-of-cost-or-market rule are avoided. Moreover, current value accounting is essential for developing a more realistic prediction

of the resources needed to continue to provide the same level of goods and services in the future and for assessing the degree of activity under various programs. A program is defined here as the process of achieving or attempting to achieve a desired result. Program activity information must depict the use of resources as inputs and the production of resources as outputs under various programs and projects. Measurements based on historical prices ignore the effects of changing prices on goods and services consumed and provided to the public. Consequently, costs to be incurred to complete prior plans and future plans cannot be reasonably estimated using historical costs. This may lead to unrealistic expectations by users if planned costs deviate significantly from actual costs due to changing prices of goods and services consumed in accomplishing the specific purpose.

34. Financial information that adjusts historical prices to reflect general price level changes ("constant dollars" as discussed in paragraph 29) does not adequately provide all the information users need in assessing program activity for two reasons: (1) it conceals differential price changes between different elements and (2) it does not focus on current market prices. For example, the index for petroleum products may be rising at a certain rate while the general price index is rising at a much lower rate or not rising at all. From this example, it is apparent that two kinds of price level changes exist: (1) the change in the market price of a particular element (a good or service) over a

period of time and (2) the general change in market prices of an aggregate of all elements. Also, constant dollars are based on historical costs and involve a general adjustment of them; however, constant dollars do not focus on current market prices. It focuses on historical costs adjusted to the current reporting date.

35. Current value concepts provide measurement methods incorporating specific and aggregate price level changes with an emphasis on current prices. An index of general purchasing power, such as that employed in the constant dollar approach, conceals price changes between different elements or components of elements. This is particularly relevant for nonmonetary elements that represent the productive capability of an entity. By measuring the results of operations at current prices, users can better assess the ability of an entity to maintain its operating capability.

36. The following example demonstrates the significant impact current value information can have on financial reporting in the Federal Government. The Department of Defense reports as of September 30, 1978, approximately $150 billion in military hardware recorded at dollars actually spent. By applying a current value concept (current costs approach based on comparable service potential developed for military hardware by the Bureau of Economic Analysis of the Department of Commerce) this asset would be increased by approximately $90 billion. As a result, the Department of Defense would report the carrying amount for military hardware at about

$240 billion. If these military assets were valued at constant dollars, the amount would be about $230 billion. In this example, current value accounting discloses an additional amount of at least $10 billion ($240-230 billion) required to replace the identical assets. Also, for those military hardware items which are depreciated by the Department of Defense, depreciation charges will be reported at a greater amount. As a result, restatement will produce a lower results from operations.

37. The concepts proposed in this statement are in contrast to the financial reporting requirements called for by the Financial Accounting Standards Board (FASB) for business enterprises. The FASB is requiring that no changes be made in the basic financial statements. The basis of valuation in financial statements will continue to be historical costs. The required information dealing with both general inflation and changing prices of specific assets is to be presented in supplementary statements, schedules, or notes in financial reports.

38. In contrast to the historical cost basis required by the FASB, no one measurement is considered to be the primary basis for reporting the classes of items in financial statements of Government entities. The selection of the measurement basis will be guided by the user needs of certain financial reports. User needs would dictate the purpose of financial reports and the measurement basis applied. For example:

--Historical costs provide an indication of the entity's compliance with laws and regulations by comparing funds expended to the dollars appropriated by Congress.

--Constant dollars provide information depicting financial viability by comparing revenues earned and costs incurred in different years on a common measure. The purpose is to show the real values by eliminating the inflationary effect of the dollar.

--Current values provide information depicting financial viability and program activity. It is helpful in assessing the costs of inputs and the value of outputs under various programs and is useful for planning future resource needs.

39. These guidelines for determining the valuation bases of elements are believed to provide useful information about the effects of changing prices on entities of the Federal Government. Current value concepts will involve not only the identification of the individual assets but also a judgment as to their significance. The decision as to which, if any, current value method should be used rests on an analysis of the relevance, costliness, and reliability of the various methods available. The following paragraphs discuss several valuation measures that could be employed in current value accounting.

CURRENT VALUATION MEASURES

40. There are numerous valuation measures which could be used in current value accounting, and at least five of them would be appropriate for Federal Government financial accounting. They are

--current market prices,

--current reproduction cost,

--current replacement cost,

--net realizable value, and

--net present value of expected future cash flows.

Conceptually, no single measure is sufficient to convey all the effects of changing prices on a Government entity. The following paragraphs define current value measures applicable to the activities of the Federal Government. Although the discussion focuses on the measurement of resources, these concepts can be used to value the claims to resources and the changes to them. In all instances, a transaction in its entirety is subject to these measurement concepts.

41. Current Market Price.

Current market price is the exchange price that would have to be paid to acquire an asset with a service potential comparable to the asset already owned. The emphasis is on the "comparable service" of the asset.

42. Current Reproduction Cost.

Current reproduction cost is the amount of cash (or its equivalent) that would have to be paid to acquire an identical asset currently. The emphasis is on the particular asset. The cost would be the buying price of an asset of the same age and in the same condition as the asset already owned. This provides a more direct measurement of the current value of a used asset than other methods. However, this alternative will produce reliable results only if there is an active market in used assets. Current reproduction cost is the preferable approach for valuing some property, plant, and equipment items. This approach is especially appropriate when technological advances have caused a used asset to be worth substantially less than its acquisition cost adjusted for depreciation. For example, an agency may have copy machines that the General Services Administration could acquire for less than the value already recorded in the agency's accounting records because of advances made in the field since the purchase.

43. The current market price described in paragraph 41 would produce an amount equal to an estimate of the buying price of a similar new asset without regard to a loss for the operating disadvantages of the asset owned, whereas reproduction cost would provide a more accurate measure of the value of the used asset.

44. Current Replacement Cost.

Current replacement cost is the amount of cash (or its equivalent) that would have to be paid to acquire currently the best asset available to undertake the function of the asset owned (less depreciation or amortization if appropriate). This concept can be identical to the current market approach discussed in paragraph 41 if the service potential of a new asset is comparable to that of the asset owned. It would often be acceptable, for instance, to substitute current replacement cost for current market price of raw materials inventories. As an example: paper inventories of the Government Printing Office can appropriately be valued at the most recent vendor's invoice price.

45. Net Realizable Value.

Under the net relizable value method, assets are measured at the amount of cash (or its equivalent) expected to be derived from sale of an asset, less costs to be incurred as a result of the sale. This concept is appropriate for valuing finished goods inventories.

46. <u>Net Present Value of Expected Future Cash Flows</u>. The last approach to be discussed measures assets at the present value of expected future cash inflows into which the asset is expected to be converted, less the present value of expected future cash outflows necessary to obtain those inflows. Net present value is an excellent measure of the worth of resources; however, its general use is not practical because it is difficult to make measurements with acceptable reliability. In certain special situations, however, the use of net present value is the only feasible solution. For example, proved oil and gas reserves could more realistically be valued on the basis of present value of estimated future cash flows. This methodology should permit full consideration of expected future economic conditions, varying discount rates, and quantities of probable reserves.

Figure 1

EFFORTS IN THE FUNDAMENTAL LEVEL

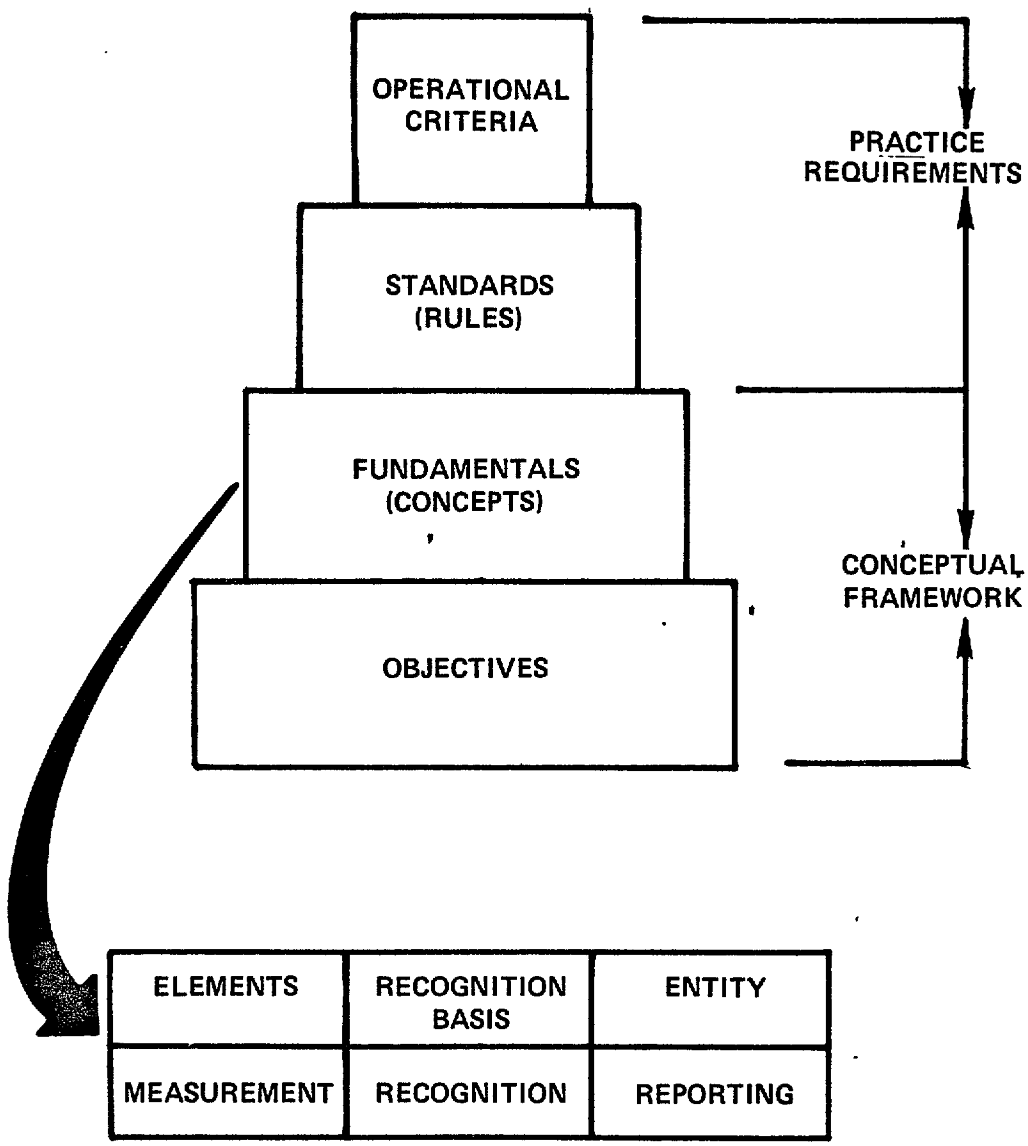

Figure 2

Brief Description of Efforts in the Fundamental Level

1. Elements statement	This statement defines and explains components of financial reports. Examples include assets, liabilities, and costs.
2. Entity statement	This statement establishes the body or activity about which financial reports will be prepared.
3. Recognition basis statement a/	This statement analyzes the three basic theories of financial reporting (funds flow, income determination, and capital maintenance) and recommends which one applies to the Federal Government.
4. Measurement statement	This statement deals with valuation criteria to be used in establishing and maintaining standards on assigning dollar amounts to elements and components of elements.
5. Recognition statement a/	This statement establishes criteria to be used when establishing and maintaining standards on when to report elements and components of elements.
6. Reporting statement	This statement establishes the criteria to guide in developing and maintaining standards on report formats and the degree of disclosure required in reports.

a/ If the effort required to determine the recognition basis is readily completed, it may be incorporated in the recognition paper.